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Trade Treaty Threats and Sub-National Sovereignty: Multilateral Trade Treaties and Their Negligible Impact on State Laws

By DAVID I. SPECTOR*

Introduction

Depending on whom you ask, free trade is either the greatest thing since sliced bread or a sure sign that the end is near. Advocates extol the virtues of trade without borders: the United States Trade Representative proudly asserts that the North American Free Trade Agreement (NAFTA) and the Uruguay Round of the World Trade Organization (WTO), "have been responsible for annual gains of between $1,260 and $2,040 for the average American family of four."[1] Conversely, opponents of open trade decry its abysmal consequences: Global Trade Watch (a division of Ralph Nader's Public Citizen) claims that the WTO, "[pries] open markets for the benefit of transnational organizations at the expense of national and local economies,"[2] and declares that "NAFTA has cost large numbers of individual workers their jobs."[3] However, Seattle protestors and Keynesian, neo-classical economists all agree that international markets are more integrated today than ever before, and consequently, the economic prospects of individual nations have

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1. UNITED STATES TRADE REPRESENTATIVE, *Benefits of Trade* (Sept. 19, 2001), at <www.ustr.gov/new/ benefits.html>.

2. GLOBAL TRADE WATCH, *World Trade Organization*, at <www.citizen.org/ trade/wto/index.cfm> (visited Feb. 27, 2004).

3. GLOBAL TRADE WATCH, *NAFTA and Workers' Rights and Jobs*, at <www.citizen.org/trade/nafta/jobs> (visited Feb. 27, 2004).

become linked to the fate of the world economy.[4]

While debates about the benefits and detriments of free trade seem never-ending, there has been comparatively little discussion of the *actual* impact of international trade obligations on the sub-national components of federal governments. Given the existence of global economic interdependence, how do trade regimes like NAFTA and the WTO affect the policies and actions of sub-national, sovereign actors like the German Länder or the American states? Although the relationship between America's trade treaties and the policies of state governments has become a more visible issue in international trade, relatively little is known about how these international trade obligations really shape state law-making among the fifty U.S. states.

Academics, state legislators, states' rights advocates and anti-trade protestors claim that, in theory, free trade threatens the sovereignty of the fifty states.[5] California State Senator Sheila Kuehl argues that her state "cannot allow agreements that are not subject to public scrutiny or input to undo the will of the [California] voters."[6] Anthony DePalma, of the *New York Times*, paints a more threatening picture:

> Their meetings are secret. Their members are generally unknown. The decisions they reach need not be fully disclosed. Yet the way a small group of international tribunals handles disputes between investors and foreign governments has led to national laws being revoked, justice systems questioned and environmental regulations challenged. And it is all in the name of protecting the rights of foreign investors under the North American Free Trade Agreement.[7]

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4. *See* Jeffrey D. Sachs & Andrew M. Warner, *Globalization and International Competitiveness: Some Broad Lessons of the Past Decade*, *in* GLOBAL COMPETITIVENESS REPORT 2000, at 18 (Center for International Development ed., 2000).

5. *See, e.g.*, A.J. Tangeman, Comment, *NAFTA and the Changing Role of State Government in a Global Economy: Will the NAFTA Federal-State Consultation Process Preserve State Sovereignty?*, 20 SEATTLE U. L. REV. 243, 243 n.1 (1996).

6. *See International Trade Agreements and the Role of the State: A Joint Informational Hearing Before the Senate Comm. on Banking, Commerce and International Trade and the Senate Select Comm. on International Trade Policy and State Legislation* (Cal. May 16, 2001) [hereinafter *Hearing*] (press release of Senate Select Comm. on International Trade Policy and State Legislation, May 15, 2001).

7. Anthony DePalma, *NAFTA's Powerful Little Secret*, N.Y. TIMES, Mar. 11, 2001, at C1.

The weekly periodical, *The Nation*, goes so far as to claim that "NAFTA has enabled multinational corporations to usurp the sovereign powers of government, not to mention the rights of citizens and communities."[8] Framed in legal terms, these critics argue that U.S. international trade obligations (obligations that have been codified in multinational trade treaties) threaten the states' sovereignty because the federal government may legally preempt any state law that is inconsistent with an international trade agreement.[9]

The reality for states, however, is not so dire as analysts, pundits and other observers fear. This Note examines how international trade treaties have actually impacted the laws of the fifty states of the Union. By looking at specific examples of state laws that have implicated U.S. trade treaties, this Note proposes that although the potential threat to state sovereignty remains real, the actual impact of multilateral trade obligations on states has been negligible. America's states are not at the mercy of international trade regimes; rather, states are free to legislate with almost complete disregard for international trade treaties, subject to a few exceptions.

Part I sets forth definitions and briefly describes the interrelation between U.S. international trade obligations, federalism, preemption and state sovereignty. By way of case study, Part II explores disputes arising from challenges to state laws under NAFTA and the WTO by examining the *Methanex* and Massachusetts Burma law disputes. Part III examines the actual impact of these international trade treaties on American states, concluding that states are generally free to legislate without fear of actual harm for violating a U.S. trade obligation. Part IV posits that this status quo is an undesirable situation for all actors involved, and makes some preliminary recommendations for potential solutions.

I. The Basics of Federalism, Preemption, Treaties and Sovereignty

A. Terms

For ease of reference, the following terms will be used throughout this Note: "U.S." and "America" refer to the federal government of the United States of America; "state" refers to any of

8. William Greider, *Sovereign Corporations*, THE NATION, Apr. 30, 2001, at 5.
9. *See, e.g.*, Tangeman, *supra* note 5, at 243 n.4.

the fifty states that make up the United States; "nation" or "country" refers to any country, including foreign countries and the United States; "NAFTA" is the common abbreviation for the North American Free Trade Agreement; "WTO" refers to both the organization as an entity and to its governing treaties.

B. Federalism and Preemption Basics

In the United States, individual states are limited in their law-making sovereignty by the federalist structure of the republic and the constitutional doctrine of preemption.[10] The U.S. Constitution establishes a federal system of government,[11] delegating wide-ranging enumerated powers to the national government, while reserving certain powers to the states.[12] Federal laws enacted pursuant to constitutionally enumerated powers are superior to state laws.[13] Through the Commerce Clause, the Constitution grants Congress the authority to regulate commerce with foreign nations;[14] because Congress controls international commerce, states are generally forbidden from legislating in the same arena.[15]

Connected, but not coupled with notions of federalism, the preemption doctrine mandates that U.S. federal law, including treaties, supersedes inconsistent state law.[16] Preemption analysis can be a very complicated process,[17] and a substantial body of work discussing the nuances of U.S. Foreign Policy Preemption exists.[18] Luckily for the author, the details of preemption are of secondary

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10. *See* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-1 (3d ed. 2000).

11. U.S. CONST. art. I, § 8.

12. U.S. CONST. amend. X.

13. U.S. CONST. art. VI, § 2.

14. U.S. CONST. art. I, § 8, cl. 3.

15. *See* TRIBE, *supra* note 10, § 6-24.

16. El Al Israel Airlines, Ltd. v. Tseng, 525 U.S. 155, 175 (1999); United States v. Pink, 315 U.S. 203, 230-31 (1942); *see generally* TRIBE, *supra* note 10, § 6-28.

17. There are three types of preemption: Express preemption applies when Congress expressly describes the extent to which a federal statute preempts state law. Conflict preemption applies when a state law clashes with federal law by imposing inconsistent obligations or interfering with the goals of the federal scheme. Field preemption applies when a state law operates in an area of law that Congress intends the federal government to occupy exclusively. These three types of preemption may also overlap. *See* TRIBE, *supra* note 10, §§ 6-28-31.

18. *See* Michael D. Ramsey, *The Power of the States in Foreign Affairs: The Original Understanding of Foreign Policy Federalism*, 75 NOTRE DAME L. REV. 341, 342 n.1 (1999).

importance for this Note; rather, this Note argues that with respect to state violations of U.S. international trade obligations, legal preemption is an extremely rare occurrence in practice. In fact, the preemptive threat of trade treaties to inconsistent state laws is no greater, and possibly less than the more traditional, domestic threat of preemption by other federal laws.

C. Treaties and the Sovereignty of Sub-National Governments

Treaties are discussed in the Supremacy Clause of the U.S. Constitution in the same breath as the Constitution and the "Laws of the United States," giving treaties the same paramount respect and preemptive force.[19] Executive Agreements, although not treaties in the strict Article II sense, have been recognized by U.S. courts as constitutional, and will be treated as equivalents for the purposes of this Note.[20] Similarly, differences between self-executing and non self-executing treaties are unimportant for this discussion. The key point is that treaties, regardless of their form, have the same preemptive effect on states as other federal laws.[21]

The United States is party to hundreds of international agreements, both bilateral and multilateral, that govern trade and commerce.[22] Analyzing the actual impact of the many bilateral treaties on states, while potentially telling, is beyond the scope of this Note. Rather, this Note focuses on the enforcement mechanisms of America's two main multilateral trade regimes, NAFTA, and the WTO. These two sets of trade obligations have received a great deal of recent attention and regulate countless areas of commerce, trade and investment.

Generally states try to encourage foreign direct investment and commerce in order to increase revenue and trade, often through innovative means. Therefore, states can benefit from increased exports and foreign direct investment due, in part, to the existence of international trade treaties. Additionally, as Justice Louis Brandeis once wrote, "it is one of the happy incidents of the federal system that

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19. U.S. CONST. art. VI, § 2.

20. *See* Made in the USA Found. v. United States, 242 F.3d 1300, 1311-12 (11th Cir. 2001), *cert. denied*, 534 U.S. 1039 (2001).

21. *See* U.S. CONST. art. VI, § 2.

22. *See* TRADE COMPLIANCE CENTER, U.S. DEPARTMENT OF COMMERCE, TRADE AGREEMENTS, available at <www.tcc.mac.doc.gov/cgi-bin/doit.cgi?205:64:416890665:0> (visited Mar. 5, 2003) (listing these agreements).

a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[23] States, as the laboratories for American democracy, have been historically innovative in legislating within their sovereign realms. States aggressively legislate to protect their environment and their citizens' health and safety, frequently with inventive laws and regulations. Problems can arise, however, when a state's innovative regulation conflicts with international trade treaties. This dilemma is at the source of a well publicized NAFTA dispute, commonly known as the *Methanex* case, examined in Part II below.

States also have a historical tradition of using spending measures to give effect to their residents' political views.[24] From the Boston Tea Party to modern day procurement laws, state and local governments have used economic legislation to raise public awareness, express moral concern and prevent local tax dollars from supporting offending practices.[25] States have used these measures to require environmental best practices and recycling, avoid purchasing goods made by children or in sweatshops, protest South Africa's apartheid policy in the 1980s, and promote human rights and religious freedom in Nigeria, Indonesia and Cuba.[26] Typical legislation of this kind either: (1) limits the procurement of goods from an offending nation; (2) refuses to award government contracts to contractors doing business with the offending nation; or (3) generally prevents state agencies from doing business and procuring goods from offending nations. Massachusetts' sanctions against Burma in 1996, examined in Part II below, illustrate the interplay between these traditional state interests, international treaty obligations and the preemption doctrine. By looking at *Methanex* and Massachusetts' Burma sanctions, this Note attempts to identify the theoretical challenges these treaties present to the states, and highlight the minimal harms these trade obligations actually impose on the laboratories of democracy.

23. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J. dissenting).

24. *See* Sarah H. Cleveland, *Crosby and the 'One-Voice' Myth in U.S. Foreign Relations*, 46 VILL. L. REV. 975, 995 (2001).

25. *Id.*

26. *Id.* at 996-98.

II. WTO and NAFTA Disputes Arising from State Actions

A. *The WTO and the States*

The WTO provides an organized procedure and process for settling trade disputes between countries.[27] A WTO dispute arises when a member nation claims that another member nation has violated a trade agreement or a commitment that it has made in the WTO.[28] Responsibility for settling disputes lies with the WTO members, through the Dispute Settlement Body.[29] Of the 306 officially lodged disputes, eighty-one have been brought against the United States.[30] Of these, only five disputes have arisen because of American states' practices.[31] Perhaps the most well known example of a state law that implicated the WTO was the so-called

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27. WTO, TRADING INTO THE FUTURE, SETTLING DISPUTES, available at <www.wto.org/english/thewto_e/whatis_e/tif_e/displ_e.htm> (visited Feb. 27, 2004) [hereinafter TRADING INTO THE FUTURE].

28. WTO, TRADE TOPICS, DISPUTE SETTLEMENT, available at <www.wto.org/english/ tratop_e/dispu_e/dispu_e.htm> (visited Feb. 27, 2004).

29. *Id.*

30. *See* WTO, TRADE TOPICS, DISPUTE SETTLEMENT, DISPUTES CHRONOLOGICALLY, available at <www.wto.org/english/tratop_e/dispu_e/ dipsu_status_e.htm> (visited Feb. 19, 2004) (listing the disputes in chronological order).

31. Two of these disputes were filed because of the Massachusetts Burma Law. *See* United States—Measure Affecting Government Procurement—Request for Consultations by Japan, July 21, 1997, WT/DS95/1 [hereinafter Request for Consultations by Japan]; United States—Measure Affecting Government Procurement—Request for Consultations by the European Communities, June 26, 1997, WT/DS88/1 [hereinafter Request for Consultations by the EC]. One dispute that never proceeded beyond initial consultations involved measures imposed by South Dakota that prohibited entry or transit to Canadian trucks carrying cattle, swine and grain. *See* United States—Certain Measures Affecting the Import of Cattle, Swine and Grain from Canada—Request for Consultations from Canada, Sept. 29, 1998, WT/DS144/1. Another dispute whose process has stalled involves the "Equalizing Excise Tax" imposed by Florida on processed orange and grapefruit Juice produced from fruit grown outside the United States. *See* United States—Equalizing Excise Tax Imposed by Florida on Processed Orange and Grapefruit Products—Request for Consultations from Brazil, Mar. 26, 2002, WT/DS250/1. The only seemingly active dispute involves both state and federal laws. The governments of Antigua and Barbuda allege that, cumulatively, certain federal, state and local laws violate the WTO with respect to the "cross-border supply of gambling and betting services." *See* United States—Measure Affecting the Cross-border Supply of Gambling and Betting Services—Request for the Establishment of a Panel by Antigua and Barbuda, June 13, 2003, WT/DS285/2. These and all other WTO disputes mentioned in this article are available at <http://docsonline.wto.org>. Data is current as of February 2004.

"Massachusetts Burma Law."

Background

In the mid-1990s, international attention focused on Burma (a.k.a. Myanmar) due to the ruling military regime's widely recognized human rights abuses against its people.[32] In response, the Commonwealth of Massachusetts enacted a law in 1996 that limited state agencies from procuring goods and services from individuals or companies doing business with Burma.[33] By the time this dispute reached the U.S. Supreme Court, nineteen other U.S. state and local governments had enacted similar laws.[34]

The Massachusetts law specifically identified, and publicly listed, companies that (1) were doing business with Burma, and (2) were simultaneously seeking procurement contracts with Massachusetts.[35] The law did not prohibit private investment in Burma; rather, it established a "preference requirement" that penalized companies doing business with Burma with a 10 percent mandatory increase in those contractors' bids for Massachusetts procurement contracts.[36] Approximately one year after the passage of the Massachusetts law, President Bill Clinton implemented federal sanctions (previously authorized by Congress) against Burma. The sanctions, prohibited, among other things, new investment by Americans in Burma.[37] Although the Massachusetts law and the federal law shared the goal of influencing the human rights situation in Burma, the two laws used substantially different measures to achieve this goal.[38]

In 1997, after having filed formal diplomatic protests about the Massachusetts law with the United States, the European Union (EU) and Japan both filed formal complaints against the United States at the WTO, alleging that by virtue of the Massachusetts law, the United

32. *See, e.g.*, HUMAN RIGHTS WATCH, *Burma*, *in* WORLD REPORT 1998, available at <www.hrw.org/worldreport/Asia-01.htm#P127_40364> (last modified Mar. 3, 2003).

33. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 366-67 (2000).

34. *Id.* at 372 n.5.

35. *Id.* at 367.

36. MASS. GEN. LAWS ANN. ch. 7, §§ 22G-22M (West 1996).

37. Foreign Operations, Export Financing, and Related Programs Appropriations Act of 1997, Pub. L. No. 104-208, § 570, 110 Stat. 3009, 3009-167 (1996); 50 U.S.C. § 1701 (2002); Exec. Order No. 13,047, 62 Fed. Reg. 28,301 (May 20, 1997).

38. Foreign Operations, Export Financing, and Related Programs Appropriations Act § 570; MASS. GEN. LAWS ANN. ch. 7, §§ 22G-22M (West 1996).

States had violated the Agreement on Government Procurement (GPA).[39] The GPA requires "non-discriminatory practices and open procedures in government procurement among member nations, and covers not only central government purchasing of goods, but also procurement of services, including public works, and procurement at the sub-central levels of government."[40] In 1998, the National Foreign Trade Council (NFTC) sued Massachusetts in federal district court seeking declaratory and injunctive relief from the Massachusetts law.[41] The NFTC argued that the Massachusetts law was unconstitutional because it infringed on the federal foreign affairs power, violated the Foreign Commerce Clause and was preempted by the federal Burma law.[42] Although resolved independently from each other, the Supreme Court case and the WTO dispute were inextricably related.

Treaty Mechanics

In the WTO, a dispute may be initiated only by a member country (contrast with NAFTA, where individual investors also have the ability to bring claims) against another member country.[43] If a WTO member country feels another member has violated an international trade agreement, the complaining country formally asks for consultations with the alleged violating country.[44] If consultations fail, the complaining country requests a panel (similar to a tribunal) to review the claim.[45] The independent panel members are generally

39. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 382-83 (2000); Request for Consultations by Japan, *supra* note 31; Request for Consultations by the EC, *supra* note 31.

40. WTO, MINISTERIAL CONFERENCES, SINGAPORE, MEDIA BRIEFS, GOVERNMENT PROCUREMENT, available at <www.wto.org/english/thewto_e/minist_e/min96_e/govproc. htm> (visited Mar. 6, 2003). The cornerstone of the GPA is national treatment: foreign suppliers, goods and services must be given treatment in government procurement no less favorable than that accorded to national suppliers, goods and services. *Id.*

41. Nat'l Foreign Trade Council v. Baker, 26 F. Supp. 2d 287 (D. Mass. 1998). The NFTC is an association of companies engaged in foreign commerce: thirty-four of its members were identified on Massachusetts' list, and one member had its bid for a procurement contract increased by 10% in accordance with the legislation. *See* Nat'l Foreign Trade Council v. Natsios, 181 F.3d 38, 48 (1st Cir. 1999).

42. *Crosby*, 530 U.S. at 371.

43. TRADING INTO THE FUTURE, *supra* note 27.

44. *Id.*

45. *Id.*

selected by the member countries involved in the dispute.[46] If the panel decides that the disputed trade measure violates the treaty in question, the panel recommends that the offending country change its practice to conform with the trade treaty.[47] If the offending country refuses to change the offending law or practice, the complaining country is then authorized to impose retaliatory trade sanctions on the offending country.[48] This adjudication proceeds according to strict timelines and established procedural rules.[49] For example, the countries involved can make use of expert testimony, and have access to limited appeals (within the WTO framework), if they so desire.[50] The United States Trade Representative (USTR) handles the WTO dispute resolution for the United States.[51]

In 1997 both the European Union (EU) and Japan requested consultations with the United States regarding the Massachusetts Burma law.[52] Both countries claimed that the United States had violated the GPA because the Massachusetts law: (1) set conditions on companies that were not essential to their ability to complete a contract; (2) imposed qualifications on companies and allowed contract awards based on political, rather than economic, considerations; (3) limited access of foreign companies to Massachusetts; and (4) generally impeded the objectives of the GPA.[53] Both countries were also "very concerned" by the proliferation of similar legislative initiatives taken by other state and local governments.[54]

After consultations between the United States, Japan and the EU proved fruitless, a dispute panel was established by the WTO's Dispute Settlement Body.[55] Although he Panel was suspended after a U.S. federal district court ruled the Massachusetts law

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

51. *See* OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, WTO AND MULTILATERAL AFFAIRS, WTO, AMERICA AND THE WORLD TRADE ORGANIZATION, available at <www.ustr.gov/html/wto_usa.html> (visited, Mar. 6, 2003).

52. Request for Consultations by Japan, *supra* note 31; Request for Consultations by the EC, *supra* note 31.

53. *Id.*

54. *Id.*

55. WTO Dispute Settlement Body—Minutes of Meeting, Oct. 21, 1998, WT/DSB/M/49.

unconstitutional,[56] it is instructive to speculate about what might have happened in the WTO dispute settlement proceedings.

Let us assume that after the United States had presented its case, the Panel eventually ruled against the United States, holding that the Massachusetts law violated the terms of the GPA. The federal government could have then negotiated with Massachusetts to try and change or revoke the law, or could have sued in federal court to preempt the Massachusetts law.[57] Because of the existence of the NFTC's action, the United States probably would not have had to sue Massachusetts itself. However, it is anyone's guess whether the United States would have sued Massachusetts absent the private party action.[58]

Failing a compromise between the United States and Massachusetts, the EU and Japan could have legally enacted retaliatory sanctions by targeting U.S. companies bidding for procurement contracts in Europe and Japan, even if these companies had no contact with Burma whatsoever. To illustrate, in April of 1999, a WTO panel ruled against the EU, finding that the EU banana importation regime violated international trade rules, unfairly hurting U.S. banana producers.[59] Marking the first time retaliatory sanctions were authorized by the WTO, the United States legally targeted certain exports from specific industries and countries for retaliation; these countries and goods had nothing to do with bananas, but rather, included Louis Vuitton plastic handbags from France, percorino cheese from Italy and cashmere sweaters from England.[60] Revisiting our WTO/Massachusetts example, the companies and industries targeted for retaliation there could have had zero contacts with

56. Trade Policy Review Body—Trade Policy Review—United States—Minutes of Meeting—Addendum—Outstanding Responses to Questions, Sep. 3, 2000, WT/TPR/M/56.

57. *See generally* TRIBE, *supra* note 10, § 6-28.

58. The U.S. Amicus Brief to the Supreme Court in *Crosby* argued forcefully in favor of preemption. *See* Brief of Amicus Curiae United States, Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363 (2000) (No. 99-474).

59. European Communities—Regime for the Importation, Sale and Distribution of Bananas—Recourse to Arbitration by the European Communities under Article 22.6 of the DSU—Decision by the Arbitrators, Apr. 9, 1999, WT/DS27/ARB [hereinafter Regime for Bananas].

60. *See, e.g.*, Helene Cooper, *U.S. Starts its Threatened Banana Fight With Europe*, WALL ST. J., Mar. 4, 1999, at A2; John Simons, *Handbags, Bed Linens Included in List of Goods Covered by Trade Sanctions*, WALL ST. J., Apr. 12, 1999, at A24.

Massachusetts or Burma, and still have been the victim of the retaliatory sanctions. The dispute never reached that boiling-point, however, because the Massachusetts Burma law was successfully challenged in the U.S. court system.

B. The Supreme Court's Decision

In 2000, the Supreme Court ruled in *Crosby v. National Foreign Trade Council* that the Massachusetts law was preempted by the federal Burma legislation, but declined to address the foreign affairs power or the dormant Foreign Commerce Clause arguments.[61] *Crosby* was a case decided on traditional preemption grounds without directly relying on the existence of a trade treaty. The Court ruled that the Massachusetts Burma law was preempted by the federal Burma law, reasoning first, that Congress intended the federal law to give the President flexible and effective control over economic sanctions against Burma; second, that Congress intended to limit economic pressure against Burma to a specific range; and finally, that the Massachusetts law was "at odds" with the President's authority to speak for the United States.[62]

The Court explained that because federal law expressly authorized the President to have power and control over economic sanctions, the Massachusetts law "obscured" the President's ability to effectively wield sanctions.[63] The Court found that the Massachusetts law limited the President's diplomatic effectiveness because it impaired his ability to work with foreign allies in addressing the situation in Burma free from inconsistencies.[64] The Court cited the EU and Japanese WTO complaints as evidence that the Massachusetts law impeded the President's ability to speak with "one voice" for the United States.[65] Furthermore, the Court cited the WTO proceedings as evidence that the Massachusetts law complicated the Executive Branch's relationship with other countries, and was an impediment to accomplishing congressional objectives of comprehensiveness and multilateral cooperation in implementing federal law.[66] The Supreme Court concluded that "this evidence . . . is

61. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 373-74, 374 n.8 (2000).
62. *Id.* at 374, 377, 380.
63. *Id.* at 381.
64. *Id.*
65. *Id.* at 383.
66. *Id.* at 383-84.

more than sufficient to show that the [Massachusetts] Act stands as an obstacle in addressing the congressional obligation to devise a comprehensive, multilateral strategy."[67]

C. NAFTA and the States

NAFTA is a multilateral trade and investment treaty among Mexico, Canada and the United States, and has been in effect for just over ten years.[68] NAFTA provides a framework for the liberalization of trade barriers by gradually eliminating tariffs between the three member countries.[69] NAFTA contains numerous mechanisms for resolving disputes: Chapter 11 provides for "investor-to-state" dispute resolution, a mechanism that allows any private investor or corporation to bring a complaint directly against any government of a NAFTA member, and have it heard by a private international tribunal.[70] In the past ten years, sub-national governmental laws (among all three NAFTA members) have accounted for eight of the thirty available Chapter 11 complaints.[71] Of these eight, only three arise from American state laws or regulations.[72] The *Methanex* case is one of these disputes.

Background

In response to complaints about groundwater, lake and reservoir contamination, the California legislature passed the MTBE Public Health and Environmental Protection Act[73] in 1997 to study the health effects of MTBE, a chemical additive that helps gasoline to burn more cleanly.[74] The legislation authorized a study of the health

67. *Id.* at 385.

68. *See* OFFICE OF NAFTA AND INTER-AMERICAN AFFAIRS, U.S. DEPARTMENT OF COMMERCE, *NAFTA Implementation*, available at <www.mac.doc.gov/nafta/ implement.html> (visited Feb. 27, 2004).

69. *See id.*

70. OFFICE OF NAFTA AND INTER-AMERICAN AFFAIRS, U.S. DEPARTMENT OF COMMERCE, *NAFTA Text, Chapter 11* [hereinafter *Chapter 11*], available at <www.mac.doc.gov/nafta/ chapter11.html> (visited Feb. 27, 2004).

71. *See* NAFTALaw.org, The Disputes, available at <www.naftaclaims.com> (visited Feb. 27, 2004) (listing the Chapter 11 disputes). Data is current as of March 2003. Canada and the United States must publish all NAFTA tribunal awards. *See id.* Although Mexico has discretion to keep NAFTA tribunal awards private, Mexico has pledged to support openness and transparency instead. *See id.*

72. *See id.* The *Loewen*, *Mondev* and *Methanex* cases each arise from alleged state violations of Chapter 11. *See id.*

73. CAL. HEALTH & SAFETY CODE § 25299.37.1 (West 1999).

74. U.S. ENVIRONMENTAL PROTECTION AGENCY, *Pollutants/Toxins, MTBE, Gasoline*, at <www.epa.gov/mtbe/gas.htm> (last updated July 2, 2002).

effects of MTBE and allowed the Governor to phase out MTBE if the additive ultimately proved to be harmful.[75] Researchers at the University of California at Davis (UC Davis) determined that MTBE had indeed contaminated lakes, groundwater sites and public water systems throughout the state. Moreover, the UC Davis study concluded that MTBE was carcinogenic and that its costs outweighed its benefits.[76] Based on the UC Davis findings, Governor Gray Davis began the MTBE phase-out process in 1999.[77]

Methanex Corporation (Methanex), a Canadian company, is the world's largest producer and marketer of Methanol,[78] the key ingredient in MTBE. Methanex, however, does not actually make MTBE itself. In December 1999, Methanex filed a claim against the United States, arguing that California's MTBE phase-out violated certain provisions of NAFTA's investment chapter.[79] A NAFTA arbitration panel is currently adjudicating Methanex's claims.[80]

Treaty Mechanics

The NAFTA investment chapter, commonly referred to as Chapter 11, has provisions designed to protect private cross-border investors (including foreign corporations) and to facilitate the settlement of related disputes.[81] In theory, laws that govern almost

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75. CAL. HEALTH & SAFETY CODE § 25299.37.1.

76. MTBE RESEARCH PROGRAM, UC TOXIC SUBSTANCES RESEARCH AND TEACHING PROGRAM, *Fact Sheet, UC Report: MTBE Fact Sheet* (Nov. 12, 1998), available at <www.ucdavis.edu>.

77. *Methanex, MTBE and NAFTA*, available at <www.methanex.com/investorcentre/MTBE.htm> (visited Mar. 6, 2003). The phase-out of MTBE was postponed until December 31, 2003. Press Release, Office of the Governor, Governor Davis Allows More Time for Ethanol Solution (Mar. 15, 2002), available at <www.energy.ca.gov/releases/2002_releases/2002-03-15_governor_mtbe.htm> (visited Mar. 1, 2004). The California Energy Commission confirmed that California refineries had successfully phased out MTBE use by the December 31, 2003 deadline. MICHAEL NYBERG & JEFF POTEET, CAL. ENERGY COMM'N, PUB. NO. 300-03-001V4, QUARTERLY REPORT CONCERNING MTBE USE IN CALIFORNIA GASOLINE: OCTOBER 1 THROUGH DECEMBER 31, 2003—REPORT TO THE LEGISLATURE, (Feb. 20, 2004).

78. Press Release, Methanex Corporation, Methanex Files Amended NAFTA Claim (Mar. 8, 2001), available at <www.methanex.com/investorcentre/MTBE.htm>.

79. Notice of Arbitration Under the Arbitration Rules of the UN Commission on International Trade Law and the North American Free Trade Agreement, between Methanex Corporation and the United States (Dec. 3, 1999), available at <www.naftaclaims.com>.

80. *See* OFFICE OF THE LEGAL ADVISOR, U.S. DEP'T OF STATE, *Methanex Corp. v. United States of America*, available at <www.state.gov/s/l/c5818.htm> (visited Feb. 25, 2004).

81. OFFICE OF THE LEGAL ADVISOR, U.S. DEP'T OF STATE, *International Claims and Investment Disputes, NAFTA Investor-State Arbitrations*, at

any imaginable area are potentially susceptible to challenge by a cross-border investor, so long as the investor has a colorable claim of expropriation or unfair treatment.[82] A private party (the Claimant) can initiate a claim for money damages against the federal government of the country where the Claimant's investment is located.[83] A claim for compensation is filed against the national government, even though the challenged law may have been enacted on a local or state level.[84] The Claimant selects a set of international arbitration rules to govern the proceeding, and arbitrators are selected by the parties.[85] The parties then submit their arguments to the arbitrators in written briefs. The entire arbitration process can take years to complete before a decision on damages is made.[86]

Here, Methanex's claim for economic damages is rooted in three distinct legal theories. First, Methanex alleges that California's MTBE phase-out is based on suspect scientific data, and therefore, the United States has not given Methanex "fair and equitable treatment" in accordance with NAFTA and international law.[87] Put

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<www.state.gov/s/l/c3439.htm> (visited Feb. 27, 2004).

82. There is almost no limit to the types of laws that could be challenged under Chapter 11. Regulations regarding food quality and agricultural safety, environmental protection, state purchasing and contract preferences, economic development, banking and insurance, growth controls, fair labor purchasing, etc., could all potentially be susceptible to a Chapter 11 challenge, assuming the law treats a foreign investor unfairly when compared to U.S. counterparts. *See Hearing, supra* note 6 (presentation of Dr. Robert Stumberg, Professor of Law, Harrison Institute for Public Law, Georgetown University, Washington, D.C.).

83. OFFICE OF NAFTA AND INTER-AMERICAN AFFAIRS, U.S. DEP'T OF COMMERCE, *NAFTA Text, Chapter Twenty: Institutional Arrangements and Dispute Settlement Procedures*, available at <www.mac.doc.gov/nafta/chapter20.html> (visited Feb. 27, 2004).

84. 19 U.S.C. § 3312 (1999). The NAFTA implementing legislation mandates a Federal-State consultation process for addressing issues that have a direct impact on the states: each state has designated a single point of contact to communicate with the USTR. *Id.*; *see Hearing, supra* note 6 (presentation of Mr. Lon Hatamiya, California Secretary of Technology, Trade and Commerce Agency). The relationship between the USTR and the states is examined *infra* at Part III.

85. *Chapter 11, supra* note 70.

86. For example, another NAFTA Chapter 11 case, Metalclad Corporation v. United Mexican States, took almost five years to resolve. *See* NAFTALaw.org, *The Disputes*, available at <www.naftaclaims.com> (visited Feb. 27, 2004).

87. In the Matter of a Claim under Chapter 11, Section A of the North American Free Trade Agreement and in the Matter of an Arbitration under UNCITRAL Arbitration Rules, between Methanex Corporation and the United States, Statement of Claim (Dec 3, 1999), ¶ 34, available at <www.naftaclaims.com> [hereinafter Statement of Claim].

simply, NAFTA forbids the United States from favoring domestic corporations over Canadian and Mexican companies.[88] Taken to its extreme, this regulation means any state law that negatively impacts a foreign corporation (whether directly or indirectly), but does not affect a U.S. corporation, could be subject to a Chapter 11 challenge.

Second, Methanex claims the California phase-out amounts to an expropriation of a Methanex investment because its business of selling methanol for use in MTBE in California gas will end.[89] Analogous to the U.S. legal concept of takings, under NAFTA, a member country must compensate a foreign investor for any expropriation (or a measure tantamount to expropriation) of their investment.[90] Here, Methanex claims that it should be compensated for the profits it could have earned from MTBE sales, had California not banned the gasoline additive.[91]

Finally, Methanex alleges that they have been discriminated against by virtue of an "improper" campaign contribution made to Governor Davis that influenced California policy with respect to MTBE.[92] Archer-Daniels-Midland, a domestic producer of ethanol, which competes with MTBE as an emission reducing gasoline additive, legally donated money to Governor Davis' election campaign. However, Methanex argues that this contribution, while not illegal per se, influenced Davis to phase out methanol in favor of ethanol, thereby violating NAFTA by giving preferential treatment to a domestic firm over a foreign company.[93]

Although the procedural mechanisms that govern the NAFTA arbitration process are fairly straight-forward, there are a few specific procedures worth noting. The arbitration panel uses principles of international law, not U.S. law, to rule on Methanex's claims.[94] The U.S. State Department defends the United States in most NAFTA

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88. Chapter 11, *supra* note 70.

89. Statement of Claim, *supra* note 87, ¶ 35.

90. *Hearing*, *supra* note 6 (presentation of Mr. Martin Wagner, Lawyer, International Program, Earthjustice Legal Defense Fund, San Francisco, California).

91. Statement of Claim, *supra* note 87, ¶ 38.

92. In the Arbitration under Chapter 11 of the North American Free Trade Agreement and under UNCITRAL Arbitration Rules, between Methanex Corporation and the United States, Claimant Methanex Corporation's Draft Amended Claim (Feb. 12, 2001), ¶ I.A., available at <www.naftaclaims.com>.

93. *Id.* ¶ VI.B.

94. *Chapter 11*, *supra* note 70.

Chapter 11 cases,[95] while most complaining investors (including Methanex) retain private counsel for the NAFTA arbitrations. In August of 2002, the NAFTA Panel ruled that it did not have jurisdiction over Methanex's claims, as pleaded.[96] The Panel allowed Methanex to clarify its argument and to specifically show how California targeted foreign Methanol producers.[97] In November 2002, Methanex filed its Second Amended Statement of Claim, which the Panel is currently reviewing.[98]

III. Actual Legal Impact of International Trade Treaties on the States

Generally, states face little actual, direct harm for violating U.S. trade obligations governed by international trade treaties. It is important to keep in mind that many laws established by treaties also have domestic corollaries enacted by Congress, implicating traditional preemption. However, if no domestic corollary exists, and the treaty is the only legal violation in question, states have little to fear from violating these international legal norms. Indeed, the USTR, Robert Zoellick, has stated that "the WTO and NAFTA agreements do not in any way preempt or invalidate . . . local laws that may be inconsistent with those agreements."[99] Zoellick reasons that although the United States has committed itself to adhere to treaty rules, "those rules do not have direct effect in U.S. law."[100] For one thing, treaties are unenforceable by private parties or other countries in U.S. courts: the states cannot be directly attacked for treaty violations unless the United States brings suit against the state, claiming preemption.[101] Furthermore, it is the U.S. federal government that pays the price,

95. OFFICE OF THE LEGAL ADVISOR, U.S. DEP'T OF STATE, *NAFTA Investor-State Arbitrations*, at <www.state.gov/s/l/c3439.htm> (visited Feb. 27, 2004).

96. Methanex Corporation v. United States, NAFTA Tribunal First Partial Award (Aug. 7, 2002), ¶ 172, available at <www.state.gov/s/l/c5818.htm>.

97. *See id.*

98. *See* In the Arbitration under Chapter 11 of the North American Free Trade Agreement and under UNCITRAL Arbitration Rules, between Methanex Corporation and the United States, Claimant Methanex Corporation's Second Amended Statement of Claim (Nov. 5, 2002), available at <www.naftaclaims.com>.

99. *Hearing*, *supra* note 6 (Appendix i, letter from Robert Zoellick to California State Senator Sheila Kuehl, Mar. 26, 2001).

100. *Id.* Surprisingly (or perhaps not), Zoellick's statement directly contradicts the generally accepted interpretation of the Supremacy Clause, namely, that the Constitution, federal laws and treaties are superior to state laws.

101. *See* 19 U.S.C. § 3312 (1999).

literally, for state violations of trade treaties.[102] In both NAFTA and the WTO, the United States must defend a state's practice, and if unsuccessful, the United States faces legal penalties for the offending state's practice.

At this point it is worth briefly exploring the role the USTR (and to some extent, the State Department) plays in the international trade treaty dispute resolution process. Both the NAFTA and GATT implementing legislation provide for a consultation process when a state law conflicts with a treaty.[103] During this process the USTR works with the offending state to try to achieve conformity with the state law and the treaty.[104] Additionally, the USTR must inform states of any matters that "directly relate to, or will potentially have a direct impact on" any state.[105] States, in turn, can inform the USTR of their positions on treaty matters, which the USTR must take into account in formulating its positions for treaty negotiations.[106] States are also supposed to be involved at each stage of the development of U.S. positions regarding treaty matters.[107] Furthermore, states have a right to participate in the defense of their laws and to be notified of the proceedings other than challenges that might have a potential state impact.[108]

Juxtaposed with this apparent collaborative process, the USTR is legally obligated to defend a state law that violates an international treaty. Any American law challenged by a WTO member, regardless of whether it is a federal or state law, must be defended by the USTR at the WTO.[109] However, the USTR (and State Department) are

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102. *See* 9 U.S.C. § 201 (1999); 28 U.S.C. § 2414 (2002), 31 U.S.C. § 1304 (2002); Principles of Federal Appropriations Law, 2d ed., Vol. III, GAO/OGC-94-33, Nov. 1994 (General Accounting Office, Office of General Counsel).

103. 19 U.S.C. §§ 3312(b)(1), 3512(b)(1).

104. *Id.*

105. 19 U.S.C. §§ 3312(b)(1)(B), 3512(b)(1)(B). The USTR does this through a state Single Point of Contact in each state who is in day-to-day contact with the USTR. *See Hearing*, *supra* note 6 (Appendix i, letter from Robert Zoellick to California State Senator Sheila Kuehl, Mar. 26, 2001).

106. 19 U.S.C. § 3312(b)(2), 3512(b)(2). The USTR has established an Intergovernmental Policy Advisory Committee on Trade, through which the state can advise the USTR on trade matters. See *Hearing*, *supra* note 6 (Appendix i, letter from Robert Zoellick to California State Senator Sheila Kuehl, Mar. 26, 2001).

107. *See* 19 U.S.C. §§ 3312(b)(1), 3512(b)(1).

108. NAFTA Implementing Act, H.R. 3450, 103d Cong. (1993) pmbl.

109. *See Hearing*, *supra* note 6 (Documents, Memorandum from the National Conference of State Legislatures regarding State Legislative Authority under NAFTA and GATT, at 3).

executive branch agencies, duty-bound to the President of the United States. If a challenged state law is contrary to a particular U.S. policy, the executive branch, through the USTR, may put pressure on a state to change or modify its law.[110] One can understand the states' misgivings about relying on the USTR to defend their laws at WTO or NAFTA dispute resolutions. The same institution that is charged with the states' legal defense is also simultaneously charged with pressuring the states to modify their laws in order to conform with international treaties. Although this positioning of the USTR certainly raises domestic political and federalism issues, the USTR's unique position does not seem to raise any real international treaty concerns. States may indeed legislate in accordance with international treaties because it is in their self-interests or to avoid a federalism confrontation with the executive branch, but states have little direct incentive to comply with the terms of an international treaty for the sake of mere compliance.

Therefore, politics aside, an international trade treaty's only direct threat to a state is when a WTO panel rules against the United States in an arbitration and retaliatory sanctions are authorized. Even then, the effect on a state will likely be small and localized to a certain industry or a certain practice.[111] A state that chooses to violate trade treaties with impunity, however, faces a number of indirect, negative domestic consequences. We will revisit our case examples to explore these issues in detail.

A. *Impact of WTO Violations on States*

The *Crosby* decision illustrates how America's WTO obligations have little direct impact on the states. Although states always face the domestic challenge of legal preemption,[112] states are immune from suit by WTO members in U.S. courts for violating the terms of a WTO agreement.[113] The United States bears the costs of the dispute resolution at the WTO, and if the United States loses its dispute, retaliatory sanctions may not reach the violating state at all.[114] Although states have the potential to be harmed by retaliatory sanctions, and face uncertain domestic political ramifications from

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110. *Id.*
111. *See supra* note 60 and accompanying text.
112. *See supra* note 16 and accompanying text.
113. *See supra* note 101 and accompanying text.
114. *See supra* notes 60, 102 and accompanying text.

violating U.S. trade obligations, generally a state that violates a WTO trade obligation walks away scot-free.

The domestic guidelines set forth by the Supreme Court in *Crosby* seem clear: when confronted with inconsistent federal legislation, a state may not enact legislation that impairs the President's ability to conduct foreign policy with one voice.[115] Despite the fact that a federal law and a similar state law may have the same goal, it is a basic constitutional principle that the federal law will always preempt the state law.[116]

Absent domestic preemption, however, the legal consequences of states violating U.S. trade obligations are negligible. States cannot be sued for violating a WTO agreement; rather, it is the U.S. federal government that will be brought into WTO dispute settlement proceedings.[117] Furthermore, the WTO dispute resolution system is organized in a manner that encourages settlement, rather than adjudication, of claims.[118] If a state law is challenged, the USTR could settle the dispute with the complaining country. As always, settlement demands compromises, which implies that the USTR would seek flexibility from the state in modifying its law so that it would no longer violate WTO trade rules. However, the state is under no legal obligation to change its practice. As *Crosby* illustrates, states will generally fight hard to retain their sovereignty, whether real or perceived.[119]

If the state fails to modify its law, the complaining country will institute legal retaliatory sanctions against the United States.[120] Retaliatory sanctions are generally illegal under international law. However, they are the officially authorized punishment for a country that violates an international trade agreement. Although the sanctions will be directed towards the WTO member country, the effect is frequently local. For example, in the recently publicized "banana case," the United States enacted retaliatory sanctions against the EU by targeting specific brands and products of particular regions and localities.[121] Consequently, chances are good that an American

115. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 381 (2000).
116. *See supra* note 16 and accompanying text.
117. *See supra* note 101 and accompanying text.
118. TRADING INTO THE FUTURE, *supra* note 27.
119. *See, e.g.*, *Crosby*, 530 U.S. at 363.
120. *See* TRADING INTO THE FUTURE, *supra* note 27.
121. *See supra* note 60 and accompanying text.

state that initially causes a WTO dispute could escape sanctions altogether.

Ironically, the WTO's only direct legal impact on the states could have nothing to do with sub-national violations of international trade treaties. States always face the threat of retaliatory sanctions, should the United States lose a WTO dispute.[122] Regardless of whether a WTO claim against the United States is the result of a federal or state WTO violation, the retaliatory sanctions imposed on the United States could impact any state's producers by imposing restrictive countervailing duties. Moreover, one state's violation of a WTO obligation could ultimately cause sanctions to be imposed on another state, otherwise completely innocent in the dispute. Therefore, states like California, with large export markets, are always likely targets of retaliatory sanctions, regardless of whether they comply with WTO obligations. It is important to note, however, that in over three hundred WTO disputes, only one dispute ended with the WTO authorizing retaliatory sanctions.[123]

The largest impact the WTO dispute resolution system has on states is indirect, and relates to the politics of federalism. Although the USTR will forcefully defend a state's challenged trade practice, the USTR's position is complicated by its dual role. Should the United States lose at the WTO, the executive branch faces the economic and political fallout of retaliatory sanctions imposed on an unknown U.S. industry.[124] Presumably, the USTR and the rest of the executive branch want to avoid being an indirect cause of sanctions on American producers. Therefore, the USTR has an incentive to avoid these sanctions by pressuring the offending state to modify its treaty-violating legislation. Taken to the extreme, this situation could have disastrous implications for U.S. federal/state relations. Would the President or Congress overtly try to pressure states that violate international trade laws? Could the threat of WTO retaliatory sanctions on the United States cause the federal government to retaliate against the states by withholding federal funds for unrelated programs? Or would the United States file suit against a state in order to preempt the state's law, knowing the litigation costs and the political repercussions such a court battle would inevitably bring?

122. *See supra* notes 48, 60 and accompanying text. Data current as of March 2003.

123. Regime for Bananas, *supra* note 59.

124. *See supra* notes 48, 60 and accompanying text.

The answers to these questions are unknown. What is clear, however, is that the greatest direct impact the WTO has on states will ultimately be realized through old fashioned American politics, rather than the legal enforcement of international norms.

B. Impact of NAFTA Violations on States

The *Methanex* case also provides a good example of how America's NAFTA obligations actually have little direct effect on the states. Although state laws will always face potential challenges by individual investors, the states themselves are exposed to no legal liability from a challenging investor.[125] The U.S. Department of State bears the costs of the NAFTA arbitration, and if the United States loses its NAFTA arbitration, an adverse damage award is paid by the federal government.[126] Although states face uncertain domestic political ramifications from violating NAFTA obligations, generally there is no adverse legal impact on a state that violates a NAFTA provision.

State laws, like their federal counterparts, are always vulnerable to challenge by a NAFTA country, or more likely, an individual investor like Methanex. Approximately 10 percent of NAFTA Chapter 11 challenges have been directed at sub-national laws or practices.[127] However, the state practice or law that is challenged is brought against, and defended by, the NAFTA member's national government.[128] The sub-national government is exposed to no legal liability from a NAFTA challenge. In America, the possibility that a state law might be preempted only exists if suit is brought by the federal government or by an American private party with standing to sue.[129]

A nation that violates the NAFTA investment chapter is

125. *See supra* notes 83, 84 and accompanying text.

126. *See* 9 U.S.C. § 201 (1999); 28 U.S.C. § 2414 (2002); 31 U.S.C. § 1304 (2002); Principles of Federal Appropriations Law, 2d ed., Vol. III, GAO/OGC-94-33, Nov. 1994 (General Accounting Office, Office of General Counsel).

127. There have been three claims aimed at American states, including the *Loewen*, *Mondev* and *Methanex* disputes. One claim has been brought against a Canadian Province, the *Sun Belt* dispute. Four claims have been aimed at Mexican states or municipalities, including the *Azinian*, *Calmark*, *Metalclad* and *Waste Management* disputes. A list of the NAFTA disputes is available at NAFTALaw.org. *See* NAFTALaw.org, *The Disputes*, available at <www.naftaclaims.com> (visited Feb. 27, 2004). Data current as of March 2003.

128. *See supra* notes 84, 95 and accompanying text.

129. *See supra* note 16 and accompanying text.

punished with monetary (legal) damages: there is no "NAFTA jail," nor does the offending country face retaliatory measures, like in the WTO regime.[130] If Methanex prevails in its claim, for example, the United States would pay the specified amount of damages to Methanex, and the California MTBE law would stay in effect.[131] A state law, like California's MTBE regulation, is not rendered invalid if the challenging investor prevails on its claim. The penalty is simply the damage award levied against the United States. Significantly, it is the federal government that actually pays the damage award, even if the offending regulation, like the one in *Methanex*, was promulgated by a state.[132] The damage award is automatically distributed from a Congressionally created "judgment fund," which already exists to pay damages that the United States might incur in international litigation.[133] Although international law provides a mechanism by which the federal courts can decline to enforce these awards if they are against U.S. public policy, the public policy exception is a very high standard,[134] and no U.S. federal court has ever overruled an international arbitration award based on the exception.[135]

Conceivably, Methanex and the United States could also choose to settle their case. It is worth repeating that it is the federal government that is a party to the arbitration, not the local or state government that enacted the offending legislation. Consequently, the State Department has have every incentive to litigate Chapter 11 claims forcefully, in order to save the United States from having to pay a large damage award. That being said, settlement may be an attractive option in a case where the evidence weighs heavily in the claimant's favor.[136] Presumably a settlement in the *Methanex* case would mean that the United States would pay a reduced damaged award, and MTBE would be re-introduced into California gasoline in some fashion. This solution would mean that the state of California

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130. *Chapter 11*, *supra* note 70.

131. *See generally id.*

132. *See supra* notes 83, 84 and accompanying text.

133. *Id.*

134. 9 U.S.C. § 201 (1999).

135. *See* Parsons & Whittemore Overseas Co. v. Societé Generale de l'Industrie du Papier, 508 F.2d 969 (2d Cir. 1974).

136. The *Methanex* claim is considered by many observers to be weak on evidence and rooted on tenuous legal ground. *See, e.g.*, William T. Warren, *Paying to Regulate: A Guide to* Methanex v. United States and NAFTA Investor Rights, 31 ENVTL. L. REP. 10,986 (Aug. 2001).

would have to compromise its MTBE policy in order to comply with the U.S./Methanex settlement.

Like the WTO regime, the largest impact NAFTA has on states is indirect, and relates to uncertain domestic political ramifications. Although a Methanex victory would not directly impact the MTBE law, the secondary effects on California are unpredictable. First, the precedential effect of a Chapter 11 arbitration loss could be detrimental to both California and the United States.[137] Imagine that Methanex, instead of dominating the methanol market, is one of many producers of methanol, all of whom happen to be based in Canada. A Methanex victory in this scenario would likely prompt the other imaginary methanol producers to sue the United States in a NAFTA tribunal, knowing that they could ride Methanex's coat-tails to a large damage award. One can easily foresee the potential for a souring relationship between the United States and California, should its MTBE law cause recurring litigation that drains federal coffers.

As always, the United States could seek the legal preemption of California's MTBE law by suing the state in federal court.[138] The United States rarely initiates preemption suits, generally preferring to intervene once the litigation has reached the appellate level.[139] Assuming the United States did sue to preempt California's MTBE law, California would likely lose its case in federal court, and the MTBE law would be preempted by NAFTA, a federal treaty.[140] In plain terms, a federal court would rule that California's MTBE law is preempted by provisions of NAFTA, and that the law is therefore invalid.

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137. Officially, Chapter 11 tribunal rulings have no force as precedent on the rulings of future panels. *See Chapter 11*, *supra* note 70, § 1136(1). Prior tribunal rulings, however, undoubtedly influence the actions of future panels. U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA), *Pollutants/Toxins, MTBE, Gasoline*, at <www.epa.gov/mtbe/gas.htm> (last updated July 2, 2002). Consequently, the EPA is working to "significantly reduce or eliminate MTBE." *Id.* Also note that the EPA has concluded that MTBE has resulted in water quality odor and taste concerns, and "in rare instances," MTBE has been found in drinking water supplies at levels well above the EPA's drinking water advisory standards. U.S. EPA, *Pollutants/Toxins, MTBE, Recommendations and Actions*, at <www.epa.gov/mtbe/action.htm> (last updated Sep. 17, 2003). Consequently, the EPA is working to "significantly reduce or eliminate MTBE." *Id.* The fact that the EPA's position is aligned with California's may reduce the potential for conflict in this case, but one can easily imagine instances where the state's interest conflicts with that of the United States.

138. *See supra* notes 16, 21 and accompanying text.

139. *See, e.g.*, United States v. Locke, 529 U.S. 89, 98 (2000).

140. *See supra* notes 16, 21 and accompanying text.

Absent preemption, the United States position is again complicated because of dual incentives. On one hand, the United States has an interest in reducing its potential damage award, and attempting to maintain a healthy political relationship with the most populous state in the union. In NAFTA disputes, the United States can better weigh its costs against the probability of prevailing in arbitration, because the costs of losing are unambiguous (in contrast to the more uncertain retaliatory sanctions of the WTO). The incentive to settle is therefore lower in a dispute where the United States has a strong chance of winning, like the *Methanex* case. That being said, the uncertain implications for U.S. federal/state relations discussed above are still very real in the NAFTA context. Simply, a state that violates NAFTA with impunity would be less likely to receive Congressional money or attention than a state that plays by the international trade rules. Conversely, states may resent being asked to compromise their citizen-protection policies so that the United States can simply save some money.

IV. Conclusions and Recommendations

In practice, international trade treaties have had little direct impact on American states. This reality is both domestically undesirable and potentially dangerous to the proliferation of free trade. After first looking at the specific lessons of these case examples, then drawing out some general conclusions, it becomes clear that the status quo is neither beneficial to the states nor to the federal government. Rather, steps should be taken to align the power and incentives of international trade at a local level, so that states can equally share in the benefits, and bear the burdens, of international trade.

A. Conclusions

If *Crosby* makes one thing clear, it is that states cannot legislate procurement with a disfavored foreign country where the federal government has also enacted similar legislation.[141] Even where the state legislation is in alignment with U.S. law, or even international law, state laws are subject to attack for the sake of maintaining the President's ability to effectively act in the international arena. A state's sovereignty is therefore limited by the federal government's

141. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 381 (2000).

involvement in international political-economic matters. However, the validity of a state procurement law in the absence of federal action is less clear.[142]

If the Massachusetts law had reached a WTO panel, the law would likely have been declared a violation of the GPA. The terms of the GPA clearly state that procurement decisions should be made in a non-discriminatory manner.[143] On one hand, this means that states must not discriminate in their procurement decisions. On the other hand, states can legislate procurement without fear of international litigation, if the legislation is arguably based on economic, rather than political, factors.[144]

Furthermore, states have real financial incentive to, at a minimum, monitor WTO disputes, because authorized retaliatory sanctions levied against a state could have a devastating impact on that state's unique export industries.[145] States with larger export and trade markets are statistically most likely to be impacted by retaliatory sanctions, although no producers, in any state, can ever be totally safe from the threat of retaliatory sanctions. The overall likelihood of a state being affected by retaliatory sanctions, however, is very low.[146] So although the WTO regime can directly impact a state's economy if another country enacts retaliatory sanctions against one of that state's producers, these scenarios will be extremely rare.

Similar to *Crosby*, the *Methanex* case teaches states some important, specific lessons. Most legal scholars agree that Methanex's claim is tenuous at best.[147] However, if Methanex's claim is upheld, some states face huge repercussions from such a decision, by virtue of their economic strength in world markets. Taken to its logical extreme, Methanex's legal theory assumes that all up-stream vendors who are adversely affected by a state regulation have a valid cause of

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142. Many states enacted procurement sanctions targeting South Africa during the Apartheid regime, although the Supreme Court never ruled on the validity of these laws. *See* TRIBE, *supra* note 10, § 6-24, at 1153-54. *But see Crosby*, 530 U.S. at 387-88.

143. WTO, TRADE TOPICS, *Plurilateral Agreement, Overview of the Agreement on Government Procurement*, available at <www.wto.org/english/tratop_e/gproc_e/over_e.htm> (visited Feb. 27, 2004). *See* Request for Consultations by Japan, *supra* note 31; Request for Consultations by the EC, *supra* note 31.

144. *See* WTO, TRADE TOPICS, *Plurilateral Agreement, Overview of the Agreement on Government Procurement*, *supra* note 143.

145. *See supra* note 60 and accompanying text.

146. *See supra* note 121 and accompanying text.

147. *See supra* note 136 and accompanying text.

action under Chapter 11.[148] Therefore, all "investors," like Methanex, who produce an ingredient or manufacture a part that is ultimately the core component of another product, would have viable claims against states that enact laws limiting or reducing the consumption of a particular product. Because this legal theory expands the idea of property to include an interest in end products, almost any state law could potentially be seen as expropriating a foreign investment.

Fortunately for the states, neither international law nor common sense support this legal theory. As evidenced by the NAFTA Arbitration Panel's previous rulings, they are skeptical of Methanex's legal claims and evidence.[149] In particular, the Panel was genuinely unconvinced that the California ban "related to" Methanex, interpreting that term as requiring a legally significant connection between the MTBE ban and Methanex or its investment.[150] Furthermore, Methanex's equitable treatment claim would likely be moot if there had been domestic producers of methanol that were adversely affected in a similar manner as Methanex. Indeed, the fact that there are no domestically owned producers of a particular product (methanol in this case) may be a rare occurrence in a world where American corporations have extremely diversified interests that cross-over international boundaries: identifying potential claims of equitable treatment may be as simple as identifying the dwindling number of industries where American corporations have no equity interest.

The *Methanex* case also shows how a state's sovereignty can be affected under NAFTA by private parties who have an investment in that state's economy. State legislators cannot ignore the potential impact of their legislation on Canadian and Mexican private parties who have investments, directly or indirectly, in the states' economies. Although the states are not impacted directly by an adverse NAFTA decision, private parties now have the power to, at a minimum, influence and shape state regulations, by sheer virtue of their ability to challenge a state law in an international arbitration forum.

Ultimately though, both *Crosby* and *Methanex* illustrate that

148. Statement of Claim, *supra* note 87, ¶ 35.

149. *See* Methanex Corporation v. United States, NAFTA Tribunal First Partial Award (Aug. 7, 2002), ¶ 172, available at <www.state.gov/s/l/c5818.htm>; Methanex Corporation v. United States, Tribunal's Response to the Investor's Request (Sep. 5, 2002), available at <www.naftaclaims.com>.

150. *See* Methanex Corporation v. United States, NAFTA Tribunal First Partial Award (Aug. 7, 2002), ¶ 138, available at <www.state.gov/s/l/c5818.htm>.

states have no real financial incentive to legislate with an eye towards international accords. The real economic harm of a NAFTA arbitration loss is bore solely by the United States. At best, a WTO arbitration loss has no economic impact on a state, and, at worst, may affect a single, targeted product or market. Generally, if something is enforceable under a treaty, there is a legal domestic corollary, but if no corollary exists, these trade treaties are unenforceable in U.S. courts. Although there is domestic political incentive to comply with international trade treaties, there is no real financial incentive for states to legislate in accord with U.S. international trade obligations.

Perhaps most importantly, these two cases illustrate that WTO and NAFTA dispute resolution directly impacts federal/state relations. *Crosby* illustrates the dual role that the USTR plays in WTO disputes, and the uncertain impact of WTO dispute settlement on inter-governmental relations. Similarly, *Methanex* shows how a state law in violation of NAFTA could cost the federal government millions of dollars. The political fallout from these types of situations could be disastrous for future relations between a state and the federal government. A state that violates U.S. trade obligations with impunity would likely have a more difficult time interacting with the federal government in other, unrelated areas.

B. Recommendations

The fact that international trade treaties have little to no direct impact on states is an objectionable reality. The focus of this Note has been explicitly limited to discussing the unspoken truth that international trade treaties do not directly impact the states, despite concerns to the contrary: this Note does not explore solutions to this unpleasant status quo. However, this Note would be incomplete without a few suggestions on how to address this problem. These recommendations are purposefully general, broad and unexplored: perhaps another author can investigate these and other options in greater detail.

Initially, states should begin drafting legislation with an eye towards WTO and NAFTA obligations in order to prevent potential disputes before they occur. For example, to avoid both domestic and WTO challenges, states could legislate procurement in an equitable manner, without regard to foreign political or human rights situations. Similarly, state lawmakers should familiarize themselves with NAFTA and the WTO agreements so that they can draft around the restrictions these agreements impose. Furthermore, for purposes of

NAFTA, state officials should identify private investors that would be impacted disproportionately from American investors, were a particular practice ceased or industry regulated. This could preemptively eliminate potential claims for violations of national treatment standards. Even a single state legislator with a cursory knowledge of the provisions (and loopholes) of these international trade agreements could be the best preventive medicine for avoiding trade treaty violations.[151]

Substantively, treaty law should be treated no differently from other Congressional law, and steps should be taken to ensure that states have an incentive to comply with trade obligations, while guaranteeing that states are able to maintain their sovereignty and their role as the laboratories of democracy. First, mechanisms must be established so that states can be more directly involved in NAFTA and WTO dispute resolution proceedings. Currently, states have only an advisory role in assisting the USTR and the State Department in the WTO and NAFTA arbitration process. In situations where a state law is the cause of the international challenge, the United States should require that a state official be a decision-making part of the defense team. This way, the state is ensured a strong voice at the proceedings, without supplanting the United States as the party to the arbitration. The state official, and the State Department/USTR could work in tandem to address the concerns of both the state and the nation simultaneously. This would have the added benefit of increasing lines of communication and could therefore help to facilitate potential settlements.

Once states are given a meaningful role in defending treaty arbitration claims, they should be held accountable for their own violations of U.S. trade obligations. Because the states had no official say in whether to join NAFTA or the WTO, they should not bear the

151. The California legislature has established the Senate Select Committee on International Trade Policy and State Legislation to assess the impact of trade agreements on California laws and regulations, to serve in an oversight and advice role and to bring more accountability to the state/federal relationship as it relates to international trade policy and its implementation. Other states that have directly addressed these issues include Maine, Massachusetts, Oregon and Vermont. *See Hearing*, *supra* note 6 (Appendix ii, Efforts by Other States to Examine Their Role in International Trade Agreements). These types of special committees are not unique to America: the British Colombia legislative assembly created a similar committee in 1998 to examine the Multilateral Agreement on Investment. *See* Chris Mooney, *Localizing Globalization*, THE AMERICAN PROSPECT, July 2-16, 2001, at 25, available at <www.prospect.org/print/V12/12/mooney-c.html>.

full brunt of an adverse ruling. However, Congress should create some sort of calculation, whereby a percentage of a NAFTA arbitration loss would be paid directly by the state treaty-violator to the United States. The United States would still pay the judgment award from the arbitration fund, but states would be required to reimburse the United States for a portion of the award. In WTO proceedings, where the United States has little control over the products targeted for retaliation, Congress should similarly require the offending state to pay a percentage of the value of the authorized sanction award. This would give states the necessary incentive to legislate with an eye towards trade treaties, and would further motivate states to seriously evaluate suspect regulations.

Finally, state violations of international trade treaties should be enforceable in U.S. federal courts by the United States only. Once states have a role in defending claims in international arbitration, if a state refuses to reimburse the United States for a portion of an adverse panel ruling (as outlined above), the federal government should be able to sue the state in federal court to enforce the portion of the judgment according to the terms set forth by Congress (as outlined above). Without exposing the states to suit from other countries or private investors, this makes treaties directly relevant to states through indirect domestic enforcement of international arbitration judgments.

Ultimately, states benefit from international trade through increased exports and foreign direct investment. These sub-national entities, however, do not currently face the risks that accompany the benefits of free trade. In practice, American international trade obligations have an infinitesimal impact on the fifty states of the Union. Despite fears to the contrary, the laboratories of democracy are free to experiment without regard to international trade treaties. These treaties, however, are as binding on states as other federal laws: steps should be taken to align the risks and incentives so that states legislate with an eye towards America's international trade obligations, regardless of whether open trade represents sliced bread or a sign that we are indeed nearing the end.